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WESTCHESTER FIRE INSURANCE COMPANY

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

LENSCRAFTERS, INC.; and EYEXAM OF CALIFORNIA, INC.,

Plaintiffs,

vs.

LIBERTY MUTUAL FIRE INSURANCE COMPANY; EXECUTIVE RISK SPECIALTY INSURANCE COMPANY; UNITED STATES FIRE INSURANCE COMPANY; MARKEL AMERICAN INSURANCE COMPANY; and WESTCHESTER FIRE INSURANCE COMPANY,

Defendants.

AND RELATED COUNTER AND CROSS-CLAIMS

CASE NO. C-07-2853 SBA

E-FILING

WESTCHESTER FIRE INSURANCE COMPANY'S REPLY TO PLAINTIFFS' OPPOSITION TO MOTION TO DISMISS THE SECOND AND THIRD CLAIMS FOR RELIEF OF PLAINTIFFS' FIRST AMENDED COMPLAINT [F.R.C.P. Rule 12(b)(6)]

Date: January 29, 2008
Time: 1:00 p.m.
Courtroom: 3
The Hon. Saundra Brown Armstrong

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MEMORANDUM OF POINTS AND AUTHORITIES

1. INTRODUCTION

Plaintiffs' opposition to this Motion to Dismiss is fatally flawed.

According to the allegations of the First Amended Complaint ("FAC"), particularly as concerns Westchester, the applicable insuring agreement is the subject Westchester policies provide that Westchester "will pay ... those sums ..." which the insured (Plaintiffs) "becomes legally obligated to pay as damages... because of 'personal injury' ... . " As stated in a very recent California Court of Appeal decision interpreting virutually identical policy language, "settlement costs [negotiated within the context of a court suit] are not damages, and thus are not within the [excess] policies' indemnity obligations" because such are not "money ordered by a court." *Aerojet-General Corporation v. Commercial Union Ins. Co.* (2007) 155 Cal.App.4th 132, 143-144, citing *County of San Diego v. Ace Property & Cas. Ins. Co.* (2005) 37 Cal.4th 406, 423. Absent a duty to indemnify, Plaintiffs cannot properly allege a breach of that duty.

Among the additional flaws in Plaintiffs' opposition to this Motion to Dismiss the second and third causes of action of the FAC is that Plaintiffs' claim for such damages is not ripe. In other words, Plaintiffs' claim for damages has not matured into a legally cognizable claim for relief in the form of damages for alleged breach of the duty to indemnify or settle. Plaintiffs have not become "**legally obligated to pay**" any sums "**as damages**" within the meaning of the insuring agreement of the subject policies. (Emphasis added.) "It is clear that **mere possibility, or even probability, that an event causing damage will result from a wrongful act does not render the act actionable [citations**]." (*Walker v. Pacific Indemnity Co.* (1960) 183 Cal.App.2d 513, 517 [6 Cal.Rptr. 924]; *Pacific Pine Lumber Co. v. Western Union Telegraph Co.* (1899) 123 Cal. 428 [56 P. 103].) *Doser v. Middlesex Mutual Ins. Co.* (1980) 101 Cal. App. 3d 883, 892. (Emphasis added.)s

Furthermore, the duty to indemnify (the Second Claim for Relief) also is not ripe. The **question of whether an insurer has a duty to indemnify the insured on a particular claim is ripe for consideration only if the insured has already incurred liability in the underlying action**. *Armstrong World Indus. v. Aetna Cas. & Sur. Co.* (1996) 45 Cal. App. 4th 1, 108. (Emphasis added.) Furthermore, "Until judgment is actually entered, the mere possibility or probability of an excess judgment does not render the refusal to settle actionable." (*Safeco Ins. Co. v. Superior Court* (1999) 71 Cal.App.4th 782, 788 [84 Cal. Rptr. 2d 43], fn. omitted; *Hamilton, supra,*

27 Cal.4th at p. 727.) "[T]here is no assurance that the insured will suffer any damage from the insurer's breach of its implied obligation to accept a reasonable settlement offer" until judgment is entered against the insured after a trial. (*Wolkowitz v. Redland Ins. Co.*, *supra*, 112 Cal.App.4th at p. 163.)" *RLI Ins. Co. v. CNA Casualty of California* (2006) 141 Cal. App. 4th 75, 82.

Plaintiffs make no such allegation. The claims for relief are based strictly on a *possible* settlement of the underlying action. There is no final settlement to which Plaintiffs are bound in the underlying action.

Additionally, Plaintiffs' general prayer for "damages according to proof" on the second and third claims for relief is insufficient even under literal Federal pleading standards. "The gravamen of this species of insurer bad faith [unwarranted refusal to settle within policy limits] lies in exposing the insured to a judgment for more money than the insurer is bound to indemnify, and accordingly, case law requires a judgment in excess of policy limits as an element of the claim. (*Finkelstein v. 20th Century Ins. Co.* (1992) 11 Cal. App. 4th 926, 929 [14 Cal. Rptr. 2d 305]; *Doser v. Middlesex Mutual Ins. Co.* (1980) 101 Cal. App. 3d 883, 891-892 [162 Cal. Rptr. 115].)" *J.B. Aguerre v. Am. Guar. & Liab. Ins. Co.* (1997) 59 Cal. App. 4th 6, 13.

Moreover, as there is no excess judgment against Plaintiffs their allegations seeking "special damages" are deficient. See *supra.*

2. AS PLAINTIFF'S CLAIMS FOR RELIEF ARE NOT PREMISED UPON "MONEY ORDERED BY A COURT," THERE CANNOT BE A VALID CLAIM FOR BREACH OF THE DUTY TO INDEMNIFY UNDER THE ALLEGED TERMS OF THE WESTCHESTER POLICIES

It warrants repeating the following facts which are conspicuously missing from the FAC. There is no excess judgment against Plaintiffs. There is no settlement.

Nevertheless, even if there were a settlement between the claimants and LensCrafters in the *Snow* Action, under the terms of the Westchester policies as alleged, and the holding in *Aerojet-General Corporation v. Commercial Union Ins. Co.*, *supra*, 155 Cal.App.4th 132, 143-144, there is no duty to indemnify and thus no breach of that duty can be pled.

> The essential pertinent facts of the *Aerojet* decision are set forth at 136, as follows: Plaintiff Aerojet filed this action for breach of contract and declaratory relief against certain excess carriers seeking indemnification for the costs of remediating groundwater contamination near its former facility in Azusa. The complaint alleges that in 2000 and 2001 various water entities filed law suits alleging that Aerojet was liable for CERCLA response costs and other costs arising out of the alleged contamination of groundwater in the San Gabriel Valley. Aerojet gave defendants notice of each lawsuit, but no excess carrier accepted Aerojet's tender of defense or indemnity.

> The water entity lawsuits were all settled in March 2002 and were subsequently dismissed in September 2002. The settlement agreement obligates Aerojet to pay approximately $175 million, which exceeds the total amount of its primary and excess insurance coverage for each year in the period of 1958—1970. Aerojet demanded payment pursuant to its policies; excess carriers all denied liability.

The question before the *Aerojet* court was "whether settlement costs negotiated *within* the context of a court suit are 'damages'." *Id.* at 143. The policy language which the *Aerojet* court addressed its analysis was the terms of the "insuring agreement," which in that instance, and with slight variation, "required the insurer to indemnify Aerojet for 'all sums which the Assured shall become legally obligated to pay, or by final judgment be adjudged to pay, to any person or persons as damages ... .'" *Id.* at 137. This language is essentially identical to the allegations of the FAC as to the Westchester policies, which allege in ¶¶ 24 (by reference to ¶17) and 26, that Westchester "will pay on behalf of the 'Insured' those sums ... which the 'Insured' by reason of liability imposed by law ... shall become legally obligated to pay as damages for: 'Personal Injury' ... ."

The *Aeroject* court held that "the settlement costs incurred by Aerojet are not damages, and thus are not within the policies' indemnity obligations." *Id.* at 143. Further the court noted that "there is no language in these policies suggesting indemnity is owed for anything other than damages." *Id.* As the *Aeroject* court noted "the record contains no order by the court directing Aerojet to pay damages" and, "[a]ccordingly, the settlement costs are outside the scope of the indemnity coverage in defendants' policies." *Id.* at 144.

Of further importance is to note how the court addressed Aerojet's argument that such a holding would "[defeat] the public policy favoring settlements, where the court declared:

> Whatever merit there may be to conflicting social and economic considerations, they have nothing whatsoever to do with our interpretation of the unambiguous contractual terms. (*Foster-Gardner*, *supra*, 18 Cal.4th at p. 888.) **If contractual language in an insurance contract is clear and unambiguous, it governs, and we do not rewrite it "for any purpose**." (*Powerine I*, *supra*, 24 Cal.4th at pp. 967, 968.) (Emphasis added.)

The *Aerojet* court therefore affirmed the trial court's grant of summary judgment in favor of the insurers sued therein on the ground that there was no breach of the duty to indemnify under the terms of the policies at issue. Here, Plaintiffs cannot even allege a settlement, let alone wished-for settlement. As such, Plaintiffs cannot allege a breach of the duty to indemnify because there is no allegation that a court ordered the payment of money by Westchester and the duty to indemnify does not extend to a settlement negotiated within the context of a court suit because such are not "damages" under the Westchester policy.

3. PLAINTIFFS DO NOT PLEAD RESULTING DAMAGES WHICH ARE ESSENTIAL TO A CLAIM FOR RELIEF BASED UPON BREACH OF A DUTY TO SETTLE

"An **essential element of a cause of action for breach of the implied covenant based on the refusal to settle is resulting damages**. (*Hamilton*, *supra*, 27 Cal.4th at p. 726.) Damages ordinarily include the entire amount of a judgment after trial, including the amount in excess of policy limits but excluding any punitive damages. (Id. at p. 725; *PPG Industries, Inc. v. Transamerica Ins. Co.*, *supra*, 20 Cal.4th at pp. 313, 315; *Comunale v. Traders & General Ins. Co.*, *supra*, 50 Cal.2d at p. 661.) *Wolkowitz v. Redland Ins. Co.* (2003) 112 Cal. App. 4th 154, 163. (Emphasis added.)

Plaintiffs attempt to remedy the absence of any factual allegations of actual loss in their FAC by raising the contention that their damages consist of litigation costs in the *Snow* Action. However, these allegations of resulting damages do not appear in the FAC and cannot be considered by this court in ruling on this Motion to Dismiss. Plaintiffs may not rely upon and the "court cannot consider material outside the complaint (e.g., facts presented in briefs, affidavits or discovery materials)." Schwarzer, Tashima & Wagstaffe, Cal. Prac. Guide: Fed. Civ. Pro. Before Trial (The Rutter Group 2007), 9:211, p. 9-61, citing *Arpin v. Santa Clara Valley Transp. Agency*, 261 F.3d 912, 925 (9th Cir. 2001).

Moreover, any such claimed "damages" would not be incurred as a result of a court imposing a "legal obligation to pay" as Plaintiffs allege the excess policies provide.

Furthermore, Plaintiffs cannot rely on general allegations of resulting damages to support "special damages." As stated above in *Wolkowitz*, damages for breach of the implied covenant based on a refusal to settle are predicated upon entry of a judgment after trial, and based upon the amount of the judgment in excess of policy limits. As Plaintiffs concede in their opposition, **there is no excess judgment**.

Further, Plaintiffs must plead resulting damages with specificity, which they have not done so. Under Federal Pleading standards, specifically, FRCP 9(g), when special damages are being claimed, they must be specifically pled. "Special damages" are those "damages that are unusual for the type of claim in question–that are not the natural damages associated with such a claim." *Avitia v. Metropolitan Club of Chicago* (7th Cir. 1995) 49 F.3d 1219, 1226. To satisfy this requirement, Plaintiffs must allege actual damages with "particularity," as well as specify facts showing such damages were the natural and direct result of defendant's conduct. *Browning v.*

Clinton, 292 F.3d 235, 245-246 (DC Cir. 2002). Plaintiffs have failed to sufficiently plead special damages and thus their claim for relief is fatal on this basis and should be dismissed.

4. PLAINTIFFS RELIANCE ON *DIAMOND HEIGHTS* AND *FULLER-AUSTIN* DOES NOT SUPPORT AN ACTIONABLE CLAIM BASED UPON AN ALLEGED REFUSAL TO PARTICIPATE IN A PROPOSED SETTLEMENT AND IS UNAVAILING

Plaintiffs assert that the California decisions of *Kelley v. British Commercial Ins. Co.* (1963) 221 Cal.App.2d 554, *Diamond Heights Homeowners Ass'n v. Nat'l Am. Ins. Co.* (1991) 227 Cal.App.3d 563 and *Fuller-Austin Insulation Co. v. Highlands Ins. Co.* (2006) 135 Cal.App.4th 958, provide support for an actionable claim for relief for an insurer's unwarranted refusal to settle. Such reliance is misplaced.

In *Kelley*, the facts are clearly distinguishable from the allegations of the FAC. Unlike the instant action, *Kelley* arose out of an action against an excess liability insurance company for failure to settle a claim within the limits of its excess policy following a trial and verdict of a personal injury lawsuit. The insured assigned his excess policy and cause of action for breach of contract to the prevailing plaintiff. The insured had a $5,000 primary policy and a $20,000 excess policy. The verdict was for $40,000. In *Kelley*, before the matter went to trial, the primary insurer tendered its limits and offered to allow the excess carrier to assume the defense, which was declined. *Id.* at p. 563.

In *Diamond Heights*, a primary insurer sued an excess insurer seeking contribution toward a stipulated judgment. In the settled action, an insured developer had been sued for construction defects. Its primary insurer provided a defense and notified the excess insurer that settlement demands exceeded primary coverage and that it was likely primary policy limits would be exhausted. (*Id.* at pp. 569-570, 574.) The excess insurer responded by investigating the case, and thereafter reserving its rights under the policy. (*Id.* at p. 575.) A few months later, defense counsel notified the excess insurer that both its assessment of the repair work and the plaintiffs' settlement demand exceeded primary policy limits, and sought information on the excess insurer's position. Though Central offered to contribute a nominal sum toward settlement, the matter settled on the first day of trial, without the excess insurer's contribution and with its objection to the settlement on the record. (*Ibid.*)

Diamond Heights held that "a primary insurer may negotiate a good faith settlement of a claim in an amount which invades excess coverage, and the primary insurer may enter into such settlement binding upon the excess insurer without the excess insurer's consent," notwithstanding a policy provision requiring consent. *Id.* at 580. In

Plaintiffs' FAC there are no allegations of a purported settlement binding on Westchester; only a desire to settle.

Furthermore, the *Diamond Heights* court "did not hold that an excess insurer breaches its policy when it rejects a reasonable settlement and simultaneously declines to undertake the defense." *Fuller-Austin Insulation Co. v. Highlands Ins. Co.*, *supra*, 135 Cal.App.4th 958, 988. Instead, it discussed the corresponding rights as between the primary and excess insurers when the primary insurer desired to settle a claim without trial, even if it invaded the excess layer over the objection of the excess insurer. It held that, under certain circumstances, the primary insurer need not obtain the excess insurer's consent to negotiate a good faith settlement of a claim in an amount which invades excess coverage nor is it barred from entering into a settlement that invades the excess layer of coverage over the objection of the excess insurer. *Diamond Heights*, *supra*, at 580-582. In accord, *Fuller-Austin*, *supra*, at 988 (an excess insurer is not without means of avoiding a proposed settlement or challenging the final settlement).

As to the *Fuller-Austin* decision, like the *Diamond Heights* decision, *Fuller-Austin* differs significantly from the FAC in that it involved an actual settlement. Like *Diamond Heights*, the decision was concerned with the corresponding rights that an excess insurer has to contest a settlement to which it did not consent and which invades the excess coverage, and whether it may be bound by such a settlement agreement. The *Fuller-Austin* court noted certain insurance treatises by quoting therefrom at 988, as follows:

> [A]n excess insurer is not without means of avoiding a proposed settlement or challenging final settlement since the excess insurer may voluntarily waive a policy provision indicating that the excess insurer is not to be called upon to assume charge of settlement or defense, and may agree to undertake the defense (once the primary insurer tenders its full policy limits) and either conduct its own settlement negotiations or take the action to trial, or the excess insurer may challenge the settlement on the ground of unreasonableness or that it is product of collusion between the primary insurer and the insured.

Lastly, neither the *Diamond Heights* nor *Fuller-Austin* decisions address when an excess insurer's alleged refusal to settle is actionable.

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5. CONCLUSION

Therefore, it is respectfully urged that this court grant the Motion to Dismiss the Second and Third Claims for Relief of Plaintiffs' FAC.

DATED: January 15, 2008

HARRIS, GREEN & DENNISON
A Professional Corporation

By: 
GARY L. GREEN
Attorneys for Defendant, Counter-Claimant
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WESTCHESTER FIRE INSURANCE COMPANY

PROOF OF SERVICE

I, SHIRLEY AOKI, am employed in the aforesaid county, State of California: I am over the age of 18 years and not a party to the within action: my business address is 5959 West Century Boulevard, Suite 1100, Los Angeles, California 90045.

On January 15, 2008, I served the following document described as:

WESTCHESTER FIRE INSURANCE COMPANY'S MOTION REPLY TO PLAINTIFFS' OPPOSITION TO MOTION TO DISMISS THE SECOND AND THIRD CLAIMS FOR RELIEF OF PLAINTIFFS' FIRST AMENDED COMPLAINT [F.R.C.P. Rule 12(b)(6)]

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Executed on January 15, 2008, at Los Angeles, California. I certify (or declare) under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Shirley Aoki
SHIRLEY AOKI